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BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
MARC SPITZER  
Commissioner  
MIKE GLEASON  
Commissioner  
KRISTIN K. MAYES  
Commissioner

Arizona Corporation Commission

DOCKETED

JUN 05 2006

DOCKETED BY

RB

IN THE MATTER OF THE APPLICATION  
OF SOUTHWEST GAS CORPORATION  
FOR PRE-APPROVAL OF COST  
RECOVERY FOR PARTICIPATION IN THE  
TRANSWESTERN PIPELINE PHOENIX  
PROJECT

DOCKET NO. G-01551A-06-0107

DECISION NO. 68753

ORDER

Open Meeting  
May 31 and June 1, 2006  
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Southwest Gas Corporation ("Southwest") is engaged in providing natural gas service within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission ("Commission").

2. On February 23, 2006, Southwest filed for Commission pre-approval of cost recovery for participation in the Transwestern Pipeline Phoenix natural gas pipeline project ("Phoenix Project"). Southwest has provided certain information to the Commission pursuant to a confidentiality agreement.

3. The Phoenix Project is a new project which Transwestern would undertake, comprising a combination of some existing pipeline capacity in some segments, and some new construction, including a lateral running down into the Phoenix metro area.

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1           4.       Southwest's filing is pursuant to the Commission's Notice of Inquiry on Natural  
2 Gas Infrastructure ("NOI"), which the Commission initiated in April 2003, to consider issues  
3 related to natural gas infrastructure and their impact on natural gas service in Arizona.

4           5.       On May 16, 2006, Staff filed its Staff Report in this matter, containing Staff's  
5 evaluation and recommendations regarding the Southwest filing. A confidential and a redacted  
6 version of the Staff Report have been put forth.

7           6.       Traditionally, Arizona shippers have received virtually all of their interstate  
8 pipeline service on the El Paso Natural Gas Company ("El Paso") pipeline system, comprising a  
9 northern system, a southern system, and a number of laterals. A small amount of northern Arizona  
10 demand is serviced via the existing Transwestern and Southern Trails pipelines, but El Paso has a  
11 monopoly on natural gas service in central and southern Arizona, including the Phoenix metro  
12 area.

13          7.       Service on El Paso has undergone a great deal of change and uncertainty in recent  
14 years and such change is likely to continue in the near future as Federal Energy Regulatory  
15 Commission ("FERC") considers El Paso's current rate proceeding and other matters. Issues of  
16 debate in recent years on the El Paso system include the allocation of delivery rights at Topock,  
17 elimination of full requirements rights for large East-of-California shippers, California's pursuit of  
18 market manipulation allegations against El Paso and others, implementation of Order 637  
19 provisions on the El Paso system, and a host of issues being addressed in the current El Paso rate  
20 proceeding at FERC.

21          8.       A fundamental difference in circumstances between California and Arizona  
22 shippers is that California shippers have a variety of supply options beyond El Paso, while Arizona  
23 shippers, including Southwest, generally do not have such options. Such an advantageous position  
24 for California has resulted in California shippers being able to negotiate discounted rates with El  
25 Paso, with Arizona shippers, including Southwest, likely to be looked upon to pay for such  
26 discounts.

27          9.       Introduction of some level of pipeline competition into central Arizona, via a  
28 project such as the proposed Transwestern Phoenix lateral, would diversify Arizona's natural gas

1 infrastructure, would provide Phoenix area shippers with a competitive option, would provide  
2 additional access to cheaper San Juan gas, and could lead to creation of a market center for natural  
3 gas pricing in Arizona.

4 10. The Staff Report discusses a variety of issues including the details of the proposed  
5 Phoenix lateral, background information, Southwest's circumstances in light of recent  
6 developments on the El Paso pipeline system, Arizona's competitive position in the Southwestern  
7 natural gas market, the impact of the proposed project on Arizona natural gas supplies,  
8 implications of El Paso's current rate proceeding before FERC, reliability issues, the agreement  
9 between Southwest and Transwestern, a cost analysis of Transwestern service to Southwest, cost  
10 recovery for Southwest, right-of-way and construction issues in Arizona, comments and filings by  
11 El Paso and the report by Navigant, Southwest's application in the broader scope of the  
12 Transwestern project, the Commission's NOI and its relationship to Southwest's application, what  
13 pre-approval means, the impact of pre-approval on Southwest's level of risk, and Staff's  
14 conclusions and recommendations.

15 11. In response to the serious issues facing Arizona's natural gas service both now and  
16 in the future, the Commission initiated the NOI in April 2003. Through the NOI, the Commission  
17 has conducted several workshops and has received a good deal of input at a number of points in  
18 the process from a variety of interested parties.

19 12. On December 18, 2003, the Commission issued its Policy Statement Regarding  
20 New Natural Gas Pipeline and Storage Costs. This policy statement addressed a number of issues  
21 including supply/infrastructure diversity, supply/infrastructure planning, the Commission's  
22 approach to new infrastructure projects, the general Commission approach, individual utility  
23 circumstances, and reporting. The policy statement also indicated that the traditional method of  
24 utilities participating in infrastructure projects and then later having the Commission review such  
25 participation is the preferred method, but given Arizona's natural gas infrastructure circumstances,  
26 the Commission would consider applications for alternate cost recovery treatment, including pre-  
27 approval.

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1           13. Southwest's filing addresses many of the topics which the Commission's  
2 December 18, 2003 Policy Statement Regarding New Natural Gas Pipeline and Storage Costs  
3 identifies.

4           14. Southwest's application requests pre-approval of specific costs related to the  
5 Transwestern capacity, including the reservation charge, volumetric rate, fuel rate, and applicable  
6 surcharges.

7           15. On February 14, 2006, Southwest entered into the Phoenix Project expansion  
8 agreement with Transwestern. The currently projected timeline for the Transwestern project is that  
9 Transwestern would file for FERC approved by August 2006, begin construction in August 2007,  
10 and commence operations in April 2008.

11           16. The precedent agreement contains a variety of termination rights for both  
12 Southwest and Transwestern, which either party can exercise at various points in the process.

13           17. Inherently any assessment of the relative merits of a new pipeline into central  
14 Arizona is difficult due to a variety of uncertainties regarding future costs and operational  
15 conditions on the El Paso system, future commodity costs, cost differentials between supply  
16 basins, and other factors, some of which are not easily quantified, including the benefits of pipe-  
17 on-pipe competition.

18           18. Southwest provided a cost analysis, with a number of scenarios that change certain  
19 inputs into the cost analysis. Staff has reviewed Southwest's analysis and for purposes of this pre-  
20 approval proceeding believes Southwest's cost comparisons appear reasonable.

21           19. The Commission has previously pre-approved recovery of costs for pipeline  
22 capacity on a new pipeline in Arizona for Arizona Public Service Company ("APS") and  
23 Southwest on the previously proposed Kinder Morgan Silver Canyon pipeline, a project which was  
24 eventually discontinued. The Commission has also pre-approved cost recovery for APS for  
25 pipeline capacity on the same Phoenix Project which is being discussed in this proceeding.

26           20. Acquisition of capacity on the proposed Phoenix lateral project by Southwest would  
27 play a role in moving the proposed project forward.

28           21. The Staff Report contains the following proposed conditions:

- The Commission retains full authority to review Southwest's gas procurement activities, including its management of all pipeline capacity and related activities, recognizing that the Commission is pre-approving the underlying acquisition of the Transwestern capacity during the initial term of the agreement with Transwestern. The pre-approval being granted in this proceeding would expire upon completion of the initial term.
- The impact, if any, on risk profile resulting from pre-approval of costs related to Transwestern pipeline capacity would be considered within the context of future Southwest rate proceedings.
- Southwest shall file a status report in Docket Control on the Transwestern project and Southwest's participation in the project with the Commission every six months, beginning in January 2007, until either Southwest begins taking service from Transwestern or Southwest's participation in the project is terminated.
- Southwest shall file a notice in Docket Control, within ten days of when the exact volumetric and fuel rates, applicable for Southwest when Southwest begins service with Transwestern, are set for the Transwestern pipeline.
- Southwest shall file a notice with Docket Control within ten days of each of the following events regarding the Transwestern project: a) Transwestern filing with FERC for approval of the pipeline, b) FERC granting approval of the pipeline, c) Transwestern beginning construction of the pipeline, d) Transwestern completing construction of the pipeline, and e) Southwest beginning to take service from the Transwestern pipeline.
- Southwest shall file a notice in Docket Control if at any time either Southwest or Transwestern exercises termination rights pursuant to the precedent agreement or if any other events significantly impact Southwest's participation in the Transwestern project, within ten days of any such action.
- Pre-approval of the specific costs related to Southwest's acquisition of capacity on the Transwestern pipeline is granted based upon the specific and unique conditions considered in this application and will in no way commit or predispose the Commission regarding any future considerations of pre-approval of costs. Rather, the standing presumption would be that the Commission would not grant pre-approval in future proceedings, absent a careful consideration of unique, serious, and important circumstances which would require such action.
- None of the pre-approved costs will be passed on to Southwest's ratepayers until all of the following occur:
  - The Transwestern pipeline is built and operational.

24. Staff has recommended that the Commission pre-approve recovery of Southwest's specific costs related to the Transwestern capacity at issue in this proceeding, including the reservation charge, volumetric rate, fuel rate, and applicable surcharges, subject to certain conditions.

3. The Commission, having reviewed the application and Staff's Memorandum dated May 17, 2006, concludes that it is in the public interest to approve the request for pre-approval of the reservation charges, volumetric rate, fuel rate, and applicable surcharges related to the Transwestern capacity at issue in this proceeding, subject to certain conditions.

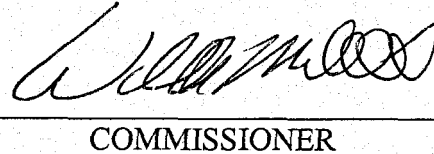
ORDER

IT IS THEREFORE ORDERED that Southwest's cost recovery of the reservation charges, volumetric rate, fuel rate, and applicable surcharges related to the Transwestern pipeline capacity at issue in this proceeding be and hereby is pre-approved as discussed herein and subject to the conditions identified in Finding of Fact No. 21.

IT IS FURTHER ORDERED that this Order shall be effective immediately.

**BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

  
CHAIRMAN

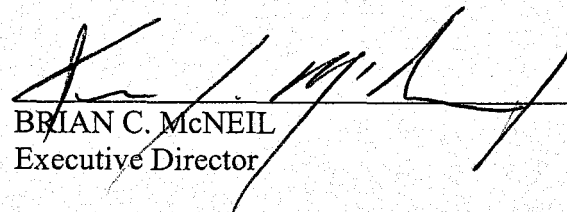
  
COMMISSIONER

  
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COMMISSIONER

IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 5<sup>th</sup> day of June, 2006.

  
BRIAN C. McNEIL  
Executive Director

DISSENT: \_\_\_\_\_

DISSENT: \_\_\_\_\_

EGJ:RGG:lhmkL

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